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Risk and the Home Equity Conversion Mortgage

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Abstract

This article analyzes the risks involved with reverse mortgage insurance and explains the pricing model developed for the Home Equity Conversion Mortgage (HECM) demonstration. The paper demonstrates how borrower longevity, interest rates and property value changes all affect pricing, and why the HECM model focuses on property value as the primary source of uncertainty. It goes on to explain why a random walk specification was chosen to forecast property values, and how the principal limit factors, which determine cash payments to borrowers in the HECM program, are calculated.

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